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Conviction versus Necessity:
Public Utility Privatization in Argentina, Chile and Mexico.

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Latin America led the world in the starting the wave of privatization after the 1973 military coup that ousted President Salvador Allende in Chile. The authoritarian regime established by Gen. Augusto Pinochet started to privatize before Margaret Thatcher in Great Britain. The ideological influence of Chicago-trained economist in the process has been widely documented (Sigmund 1990, Silva 1996). Nevertheless, by the 1990s privatization has spread all over the region regardless of government ideologies. As a result, privatization and regulation of public utilities in Latin America is usually explained by technical considerations about the efficiency of private utilities over public ones, the pressure of interest groups, or the strain of fiscal deficits. Policy convergence has displaced ideological orientation in explaining privatization and regulatory choices in the region.

This paper focuses on the role of ideological orientation, as a system of beliefs prescribing actions and defining coalition partners, in the privatization of public utilities. It does not seek to explain whether governments privatize or not, but rather to assess the influence of economic ideologies in explaining different patterns of public utility privatization. To achieve this goal, it studies three dimensions of the process: its origin, the regulatory choices associated with privatization, and its beneficiaries. These dimensions are important to measure to what extent did ideological orientations disappeared or just transformed their influence on policy-making in the region.

The argument of the paper is that right-wing governments undertake public utility privatization by conviction because they believe in the superiority of markets for resource allocation. To the contrary, left wing or populist governments, who had previously promoted nationalization, privatize by necessity in search of financial and political resources. Had ideology played no role, there should be little regulatory variation within each industry. Yet, the distinct origin of privatization results in different patterns of implementation related to the role of state regulations in promoting economic development. Populist and left wing governments, who privatize by necessity, are less willing to relinquish state regulation to achieve developmental goals than right-wing governments, who privatize by convictions. Hence, populist and left wing privatizers are more likely to establish developmental targets and to create regulatory agencies to control their realization in the privatized industries. Similarly, if ideological orientations had no influence, the beneficiaries of privatization should be different from those of nationalization and similar across countries. However, the privatizing parties had previously forged political coalitions based on their traditional ideological orientation and the policies associated with them. These political alliances defined around the traditional ideologies of the privatizing government influence who were the groups that benefited from public utility privatization.

A final section of the paper explores the implications of this argument for post-privatization regulatory policies. If political ideology influences the implementation of public utility privatization, its interaction with electoral competition should affect the post privatization regulatory policies. Electoral competitors of privatizing governments have the choice to regulate the incumbents emerging from privatization when they get to power. Ideological orientation and political alliances, along with demands from actors in the privatized industries, should influence their incentives for taking this opportunity.

To test this argument, this paper analyzes the privatization of public utilities in Argentina, Chile, and Mexico. Public utilities provide an excellent setting to test the effects of ideological orientations and political alliances on the implementation of the privatization and on regulatory change. The comparison between two industries—electricity and telecommunications—with different levels of technological change also facilitates assessing the effect of industry-specific factors across different national contexts.

These two industries had economic and political importance that makes their privatization publicly visible. Public utilities have traditionally been considered ‘natural monopolies’, thus, making them more vulnerable to expropriation.¹ Additionally, segments within these industries have recently become open to competition making the institutional choices of privatization more politically salient. Moreover, these were two industries fundamental for economic development, which as public services have a strong effect on the everyday life of citizens. This combination increased their public visibility and the stakes of even smaller players, such as consumers. Finally, these sectors were attractive for foreign direct investment because the international consolidation of these industries increased the incentives of transnational corporations to search for new markets.

Latin America as a region has fully embraced privatization more than any other area of the world. Privatization was a sweeping wave that reduced the state-owned enterprises' share of the global GDP from over ten percent in 1979 to less than six percent by the end of the century (Megginson and Netter 2000:51). In the first half of the nineties, Latin America accounted for almost sixty percent of world privatization proceeds (IADB 1996:167). In the 1984-1996 period, Latin America moved faster into privatization of telecommunications than any other region of the developing world, with Chile, Mexico and Argentina leading the process.² Latin America was also leading the world in terms of electric energy privatization while Argentina and Chile implemented the most extensive processes of the region.³ Due to the regional spread of privatization, ideology seemed not to matter any more in Latin America. This context, and the fact that these have been early cases of public utility privatization, makes them ideal to test the argument as well as its implications for post-privatization regulatory changes.

¹ "The combination of large investments in durable, specific assets and strong politicization means that utilities are particularly vulnerable to administrative expropriation of their vast quasi-rents. The easiest form of administrative expropriation is to set utility prices below the company's long-run average costs. More subtle are specific requirements for investment, equipment purchase, or labor contracts that extract quasi-rents as well." (Levy and Spiller 1995:3). Technological changes, however, have recently permitted competition in telecommunications. Competition in electricity generation is spreading although its investments are high, durable and immovable, "in the cases of transmissions and distribution, economies of scales and high sunk costs create conditions of natural monopoly, where a single network of facilities can provide transmission or distribution services more efficiently than duplicative systems." (Ruffin 2000: 113).

² "Countries from the Americas were among the first to sell state-owned carriers to foreign investors, and among these, developing nations such as Argentina, Chile, and Mexico sold controlling share of incumbent carriers to strategic investors." (ITU 1998:9).

³ Chile started its design of electricity privatization in 1982 and started the process in 1986 making it a leading case in the world, even before Britain. Ruffin (2000) also finds a strong regional effect for electricity privatization in Latin America for a sample of more than one hundred advanced industrial and developing countries.

The paper has four sections. The first section presents the puzzle of seemingly "de-ideologized" public utility privatization. The second section focuses on the effect of ideological orientations and associated political alliances in explaining different patterns in the implementation of public utility privatization. The third section tests the argument using the case studies of Argentina, Chile, and Mexico. The last section provides a preliminary presentation of the implications of the argument for post-privatization regulatory reform.

I-From Nationalization to Privatization of Public Utilities

In Latin America, after the crisis of the eighties, the change in development strategy from state-led to market-oriented pervaded both left-wing and right-wing governments.⁴ As much as nationalization was a key policy in the state-led development strategy, privatization became a cornerstone of the market-oriented one. Arguments about the most efficient allocation of resources were reversed with the same aim of fostering economic growth and the general interest. Additionally, in the process of nationalization and privatization of public utilities, the inefficiency of monopolies was used to justify policies in defense of potential and current consumers.⁵

During the postwar era, emerging populist political parties use nationalization as a fundamental policy of an agenda that claimed to represent the broader interest of the nation. Nationalization was particularly instrumental for populist parties whose support coalition came from workers, consumers and domestic business sectors.⁶ Nationalization of public utilities usually implied taking over foreign-owned assets and, thus, hurting players that were external to the domestic political system. The beneficiaries included domestic business sectors, which became suppliers or received subsidized rates to foster national production, workers who received higher salaries and benefits, and residential consumers who obtained lower prices and extended coverage of their public services. The costs of these subsidies were not perceived immediately. Even when the Treasury had to start covering the deficits of state-owned public utilities, tax evasion and indirect taxation--mainly through inflation--dispersed the distribution of costs in contrast to the concentration of benefits. Hence, nationalization had been a policy asset for Latin American populism. However, when the state-led development strategy definitively lost its appeal in the midst of the eighties' recession, the turn toward market-oriented policies and privatization did not necessarily benefit the right-wing parties in the same way.

⁴ During the post-war era, state intervention, state-owned companies, and state-led industrialization were at the core of Latin American economic-policy making with the aim of accelerating economic and social development (Hirshman 1968, Evans 1979, Haggard 1990, Sikkins 1991, Glade 1996). According to Edwards (1995:71), state-owned enterprises were considered an efficient way to deal with externalities, in particular natural monopolies, were supposed to serve the public interest, and to reduce the vulnerability of the economy to external shocks.

⁵ See Gómez-Ibañez (1999) for an analysis of utilities' nationalization in the region.

⁶ The vast literature on the constituting coalitions of Latin American populist movements includes Drake (1991), Conniff (1982), O'Donnell (1973), Kaufman and Stallings (1991), Collier and Collier (1991), Cardoso and Faletto (1969), Di Tella (1965), and Weffort (1973). Bates (1981) provides a more general theory about the use of state subsidies and state-owned enterprises to build governing political coalitions and applies it to Africa.

Governments privatizing public utilities included not just right-wing parties--long-term defendants of market allocation--but also populist parties, which had promoted and implemented nationalization of these very same utilities. Old-time populist parties, like the MNR (National Revolutionary Movement) in Bolivia, the Peronism in Argentina, AD (Democratic Action) in Venezuela, and the PRI (Institutional Revolutionary Party) in Mexico led their countries into privatization of public utilities even though these parties had previously been the frontrunners of nationalization. This policy shift made their privatizing zeal more surprising than those of right-wing governments, such as Pinochet in Chile or Chamorro in Nicaragua. It seemed that ideologies were finally killed, either by the supremacy of technocracy, the pressure from international financial institutions or the implacable logic of economic "efficiency." Should we infer that ideology played no role in the case privatization of public utilities in Latin America? Was this "de-ideologized" character of privatization a regional trait due to the sweeping force of the privatization wave in Latin America?

Ideology as a system of belief is supposed to constrain policy choices by providing a set of alternatives consistent with it. Political parties have adopted these ideological orientations and followed their policy prescriptions when they were viable in economic, political, and administrative terms. These policies cemented their alliances with their political support coalition based on the combination of interest and identities they forged (Hall 1989, Gourevitch 1989). During the 1990s, parties of different economic ideologies seemed to converge in terms of their policy options in Latin America, especially regarding privatization. Ikenberry (1990) explained the spread of privatization by the combination of economic and technological change, external inducement from creditors and multilateral organizations, and policy emulation or "bandwagoning." Latin America politicians became more attentive to advocates of privatization due to the debt and fiscal crises of the eighties, along with the failure of policies associated with state intervention to solve these problems.⁷ Multilateral organization, creditors, and business increased their policy influence under these conditions.⁸ In this context, the objectives of privatization seemed to be purely economic: raising fiscal revenue, promoting economic efficiency, broadening stock ownership, attracting foreign capital, and providing more opportunities to introduce competition.⁹

The role of politics was limited to the "successful" implementation of privatization. The commitment of technocrats and foreign-trained officials, as well as the influence of multilateral organizations, as carriers of policy emulation, did not necessarily guaranteed policy

⁷ Castelar Pinheiro and Schneider (1994), Armijo (1999), and Turcotte and Faucher (1999) emphasize the financial urgency of governments in terms of fiscal revenue and credit availability in explaining Latin American privatization. However, fiscal revenue maximization was clearly not the objective in Chile or in the Eastern European privatization processes that resorted to "popular capitalism" or "voucher privatization" (Stark and Bruzst 1998).

⁸ Williamson (1994) coined the term "Washington Consensus" to highlight the influence of ideas and multilateral organizations in policy convergence.

⁹ See Meggison and Netter (2000:6) for a review of the literature on privatization summarizing its objectives and Edwards (1996) for a Latin American account.

implementation.¹⁰ The coalitions benefiting from nationalization were different from those gaining from privatization (Ikenberry 1990: 95). The losers of privatization--either suppliers, workers or even subsidized consumers--had large stakes whereas the beneficiaries--buyers and potential or dissatisfied consumers were less organized and more uncertain about their gains. Because these policies had been technically defined as "public goods", they could be derailed by concentrated "vested interests" whereas their diffuse and less certain beneficiaries would not organize to defend them, thus making privatization difficult to implement.¹¹ The literature on the politics of privatization focused on the "success" of privatization despite the aforementioned difficulties for its implementation.

Because the politics of privatization were restricted to imposing technical policies, executive authority to dismantle opposition from "vested interests" was considered a precondition for the success of privatization and other market-oriented policies.¹² Government authority and capabilities were single out as key for the implementation of privatization.¹³ In particular, institutional executive authority through decrees and a reduced number of veto points became important to insulate policy-makers and allow privatization. However, even without discussing the normative implication of the concentration of executive authority, the empirical work on market reforms, including privatization, shows a great deal of bargaining in the processes.¹⁴

For the literature on privatization, bargaining over privatization was still limited to its implementation and deprived of ideological content. Corrales (1998) argues that, in Argentina, rewards were used to fend off opposition from "vested interests." Feigenbaum, Henig and Hamnett (1999) point out that privatization could also serve as a form of patronage to reward supporters or campaign contributions. In contrast, Schamis (1999) sees patronage as the result of rent-seeking pressures by business conglomerates who after

¹⁰ Kahler (1992), Stallings (1990) and Ikenberry (1990) emphasize policy emulation and international influence through multi-lateral organizations whereas Dominguez et al (1997) focus on the role of 'technopols' in diffusing and implementing these ideas.

¹¹ Rodrik (1996) provides an excellent summary of these distributive arguments and Przeworski (1990) highlights the political difficulties derived from considering market reforms as public goods. According to Edwards (1995:174), the groups that have previously benefited from excessive regulation and state-owned enterprises created difficulties to implement privatization in Latin America.

¹² The degree of executive concentration of power required for reforms was never specified but it range from authoritarianism to "delegative democracy"--lacking checks and balance on the power of the executive-- to strong presidents with ample decree power (O'Donnell 1997, Haggard and Kaufman 1992, Roberts 1995).

¹³ Manzetti (2000:13) points out to five key factors regarding government capabilities for privatization: cohesive economic team, technical and administrative capabilities, bureaucratic cooperation, concentrated executive authority, and speed. Margheritis (1999) makes a case for strong Presidential leadership as a key variable in explaining Argentine privatization process in general and Molano (1997) and Petrazzini (1995) emphasize this variable to explain the success of telecommunications' privatization in a comparison of Argentina, Mexico, and Brazil.

¹⁴ From a normative perspective, Shapiro (1999:54-56) questions the imposition from above of market reforms defined as "public goods." He argues that because those who claim to provide public goods may have ulterior motives, these policies should receive "strict scrutiny" from the Courts and justified only when the good provided is essential to the operation of a democratic order and cannot be attained in other ways. From an empirical perspective, my previous work in the region shows a great deal of bargaining between populist parties and labor unions over the implementation of market-reforms, including privatization (Murillo 2001).

depleting the public coffers forced the government into privatization to take over state assets.¹⁵

Departing from this literature, this paper does not study the success of governments in privatizing. It focuses on how privatizing governments actually implement the process. Governmental choices in terms of privatization are not reduced to imposing policies, buying out opponents, or selling out to strong business conglomerates. The ideological orientation of political parties and their political alliances, which has traditionally been considered as an important factor for defining policy preferences, still influences the implementation of privatization.¹⁶ Hence, when parties of different ideological orientation and with diverse political support coalitions privatize public utilities, they do it differently.

Different ideological orientations are associated with different types of public utility privatization. Three dimension of the process expressed this variation: its origin, the regulatory decisions related to privatization, and its beneficiaries. Ideological orientation influences the original decision to privatize (origin) and the confidence of decision-makers on markets for development (regulations). Right-wing parties privatized by conviction whereas populist and left wing parties adopt this policy by necessity. Right-wing governments have a long tradition of distrusting regulations whereas populists and left wing parties have long distrusted markets to achieve their developmental goals and tend to regulate privatized industries to realize their growth objectives. Additionally, the redistribution of property, either nationalization or privatization, is useful for consolidating political coalitions, and thus, for strengthening political authority and electoral support. The beneficiaries of privatization vary depending on the political alliances established by privatizing governments. Hence, privatizing governments define selling conditions according to who are their political constituencies. In sum, ideological orientations and political alliances shape the implementation of public utility privatization despite the increasing influence of technocrats, multi-lateral organizations, creditors, and business in the policy-making of the region.

II- The Politics of Privatizing by Conviction and by Necessity

The use of “ideology” is this paper focuses on its economic components, with a particular emphasis on the traditional ideas regarding the role of the state and the market in economic development. In Latin America, these ideas divided right-wing parties on the one side and left-wing and populist parties on the other. During the postwar era, the former defended market allocation of resources and the second favored state intervention. Although left-

¹⁵ Schamis (1999) makes a strong case for privatization as just a new form of "rent-seeking" by the powerful business conglomerates in Latin America, which imposed their policy preferences to government officials. Schamis emphasizes business' pressures--due to the exhaustion of government coffers to continue providing for subsidies through state-owned enterprises--to explain the policy change.

¹⁶ Referring to the adoption of Keynesian policies, Hall (1989:376) summarizes an array of empirical studies arguing that "the orientation of the governing party appears to have been the single most important factor affecting the likelihood that a nation would pursue Keynesian policies." Analyzing privatization in OECD countries, Boix (1997) argues that right-wing and left-wing governments have different policy preferences regarding privatization and right-wing governments are more likely to privatize.

wing and populist parties had different views on the degree of state intervention, they share the idea of market failures in contrast to right-wing parties. Both left wing and populist parties competed for attracting organized labor into their support coalitions in contrast with right-wing parties who distrust organized labor. Right-wing parties prefer to privatize whereas populist and left-wing parties do not. Right-wing parties privatize by conviction because they had promoted market allocation of resources even before the policy convergence of the nineties.¹⁷ In contrast, populist and left wing parties had been staunch defendants of nationalization and state intervention to compensate for the failures of markets to achieve developmental goals. If they implemented privatization in the nineties, they changed their traditional policy preferences by necessity.

I use the occurrence of privatization as an indicator of their ideological conversion because my dependent variable is not the privatization of public utilities, but its implementation and subsequent regulation. My explanatory variable is the ideological orientation of the privatizing government. Whereas right-wing parties should implement privatization by conviction, left wing or populist parties should implement privatization by necessity. The differences in origin between both types of privatization determine variation in regulatory choices at the time of privatization (how much was left for the market?) and in terms of who benefits from privatization (who benefited by privatization? What was the effect of selling conditions on this outcome?).¹⁸

a) Origin

How does privatization start? Privatization by necessity starts under conditions that make selling state-owned enterprises useful for collecting political resources. Fiscal deficits and insufficient credit increase the attractiveness of privatization because alternative policies, such as cutting expenditures or raising taxes, are not popular. The revenue obtained in privatization, along with the decline in the drainage of public moneys provoked by the deficits of state-owned enterprises, can serve to implement popular policies with an electoral payoff. Additionally, the sale of public utilities in two internationally attractive industries could serve to recover or repay debt, thus improving financial credibility and governmental access to financing (external or domestic) for other policies as well. Moreover, fiscal crises reduce the attractiveness of bankrupt state-owned enterprises for suppliers, workers, and unsatisfied consumers whose subsidies are disappearing, reducing their opposition to privatization. Instead, privatization can bring investment for these industries while improving services, thus increasing its appeal for members of the nationalization coalition.

Coalition building is an important component of public utility privatization, as it was of nationalization. The use of privatization for coalition building provides political resources that could improve the electoral opportunities of privatizing governments and their ability to implement other policies. Weak governments in particular can benefit from the positive

¹⁷ I am ignoring the right-wing defendants of state intervention of a corporatist type, such as fascist parties for the sake of simplicity.

¹⁸ The origin or decision to pursue a policy, included privatization, was linked to ideological preferences as discussed on FN 16; the attitude toward state regulations was the birthmark of different ideological orientations, which represented diverse political coalitions.

impact of privatization on political resources and weak governments under the strain of economic crisis are more likely to take the risk implied in policy innovation (Remmer 1998, Weyland 1998). To the contrary, privatization by conviction does not need economic or political pressures to be adopted because it is related to the belief on the superiority of market allocation and it does not require any policy conversion.

b) Regulations

How much market, how much state? Privatization by conviction differs from privatization by necessity in terms of the role of state regulations regarding economic development. Because privatization by necessity was undertaken to recover state authority, policy makers implementing it usually refuse to relinquish their authority. Hence, they seek to maximize fiscal resources and to retain some power to regulate privatized industries. To achieve both goals they can include fixed-term monopolies of competitive sectors, which increase fiscal resources, and developmental targets, such as increasing investment, decreasing prices, fostering "national champions" or avoiding market concentration.¹⁹ They can also create regulatory agencies in the privatized industries to oversee the realization of these goals.

To the contrary, privatization by conviction is associated with distrust on the effect of state intervention on economic development. Hence, it usually imposes fewer regulations on privatized markets and does not create legal monopolies. In this case, policy makers distrust regulatory agencies in the privatized industries as prone to increase transaction costs whereas the problems of market concentration could be left to anti-trust courts or regulators. Therefore, the distinct origins of public utility privatization are associated with diverse patterns of regulating these industries derived from the different ideological orientations of privatizing governments regarding economic development.

c) Beneficiaries: Selling Conditions and Winning Coalitions

Who benefited from privatization? Selling conditions and the use of privatization resources can subsidize different groups, as much as nationalization did in the past. The beneficiaries of the process should be different according to who are the allies of the privatizing government. Whereas the allies of the privatizing government depend on the political constellation of each country, we should expect certain groups to benefit from certain types of privatizing governments.

Privatization by necessity substitutes nationalization in economic and political terms. Economic and political pressures provoked the adoption of pragmatic privatization to accumulate financial and political resources that strengthen governmental authority. Policy makers use these resources to implement other policies, and more importantly to retain power. Hence, privatization by necessity substitutes nationalization, not just in terms of

¹⁹ Regulations, however, could be used to restrict or to foster competition. The outcome will be different although in all cases regulations were used to limit market discretion. In particular, governments tend to use microeconomic regulation for macroeconomic goals, such as controlling inflation, which have a stronger electoral effect.

economic feasibility, but also political efficiency because it helps to build governmental authority.²⁰

In privatization by necessity, coalition building should include the traditional constituencies of populist and left wing parties, who had benefited from nationalization, while trying to add supporters of the new policies. In this case, we should expect the participation of groups that were not supposed to be among the beneficiaries of public utility privatization, but among the losers, such as state suppliers and labor unions. Because this policy was adopted to accumulate political resources, we also expect these parties to prioritize state resources for distributing gains to other constituencies in their coalition, who cannot participate in privatization.

In contrast, we expect governments privatizing by conviction to lure support from the middle and upper classes by dispersing ownership rather than maximizing state resources (e.g. "popular capitalism"), as well as other loyal constituencies (e.g. military in a military regime). The following table summarizes the expected effect of ideological orientation and political alliance on the implementation of private utility privatization.

Table 1- Ideology and Public Utility Privatization (predictions)

Ideological Orientation	Right wing	Populist or Left wing
Origin	By conviction	By necessity
Regulations	No legal barriers to entry No regulations on market concentration for the industry Distrust of industry-level regulatory agencies.	Legal barriers to entry Regulations on market concentration for the industry Regulatory agencies
Beneficiaries	Middle classes No state	Domestic capitalists Labor unions State (resources)

In short, ideological orientation and political alliances influence the origin of public utility privatization and its subsequent implementation in terms of regulations. Privatization, in turn, facilitates coalition building and the consolidation of executive authority, but its beneficiaries are also different depending on ideology and political alliances of the privatizing governments. The cases studied test this argument.

²⁰ Manzetti (2000:11) argues that privatization in Latin America was the result of "policy substitution." That is, policy makers perceived that public intervention ceased to be viable for dealing with the eighties recession as much as it was to cope with the Great Depression. The alternative policy to solve economic policies was privatization. My view stresses the political substitution of nationalization for privatization as an instrument for increasing fiscal resources and building support coalitions in transitional economies with institutional fluidity.

III- Public Utility Privatization in Argentina, Chile and Mexico

The studied cases are the privatization of telecommunication in Argentina, Chile and Mexico and the privatization of electricity in Argentina and Chile.²¹ The three countries had similar levels of development and led the regional process of privatization. Privatization, though, was undertaken by different regimes in each of these countries—democracy in Argentina, military authoritarianism in Chile, and liberalizing authoritarianism in Mexico.²² In Argentina and in Mexico, populist parties were in power whereas Chile had a right-wing government. Economic variables, such as fiscal deficit were also different at the time of privatization whereas many of the regional variables that characterized the region remained constant.²³

a) Origin

The origin of privatization was different in Chile with a right-wing government than in Mexico and Argentina with populist parties in power. In Chile, policy-makers privatize by conviction whereas in Argentina and Mexico, populist parties in power privatize by necessity under the strain of economic crises and political challenges.

In Chile, neoliberal policies started in 1973, as a reaction to the Socialist administration of Salvador Allende, which ended in a military coup in defense of "private property." The new military government followed the neoliberal ideas of a group of technocrats trained in the Economics Department of the University of Chicago and started to privatize the companies nationalized by Allende.²⁴ The process of public utility privatization was in preparation since the early 1980s. A test involving the privatization of small electricity (1980) and telecommunications (1981) companies was followed by new rules for both sectors to prepare large-scale privatization in 1982 (Moguillansky 2000:174, 217). Indeed, the shock provoked by the debt crisis in the Chilean economy delayed the process. The debt crisis hit Chile the hardest of the countries in the region, and the reaction of policy-makers was to slow-down the implementation of neoliberal policies, even establishing transitory tariffs restrictions and taking over foreign private debt with the unintended consequence of bank

²¹ Despite the concentration of executive authority, Mexico did not privatized electricity. Salinas did not intend to privatize because he did not face any delivery crisis and his labor allies in electricity opposed privatization in contrast to what happened in telecommunications. The lack of delivery crisis made this policy unpopular with large consumers as well.

²² Ruffin (2000) argues that ideology plays a role in the preference for privatization when politicians attach a great weight to their own ideology and contributions are not feasible or when consumers are not allowed to vote on ideological regime choices (i.e. authoritarianism). The studied cases, however, show its influence across regimes and regardless of electoral contributions.

²³ The following section provides a preliminary description of indicators in the studied cases. I am not focusing on the influence of international financial institutions, which has been others, to highlight the domestic effects of politics. See FN 10.

²⁴ "Privatization was not carried out because of a need to relieve the burden of state enterprises deficits; that problem was resolved relatively quickly after the 1973 coup. Rather, the Chicago boys were committed to a vision of a decentralized and privatized economy as morally, politically, and economically superior to the long Chilean tradition of state intervention" (Sigmund 1990: 359-60).

nationalization (Edwards 1995, Silva 1996).²⁵ In fact, this episode implied a re-nationalization of debtor companies, which increased the stakes for the success of privatization to prove the superiority of market economies. The Chilean government started both the privatization of electricity and telecommunications only in 1986, after the economy had begun to recover in 1984 and 1985.²⁶ Additionally, the coalition emerged from the selling conditions would serve to support Pinochet's mandate in the 1988 plebiscite on his continuity in power. Hence, this policy was undertaken as an ideological preference rather than as a desperate call for survival.²⁷

In contrast, policy makers in Argentina and Mexico moved toward privatization under the strain provoked by economic crisis and political weakness. Argentina started the privatization process with the national publicly-owned monopoly in telecommunications in 1990. Mexico privatized its national telecommunication monopoly on the same year.

In Argentina, the decision to start privatization was taken under economic hardship. President Menem was inaugurated in 1989. That year, the GDP dropped by more than 6% and the annual rate of inflation surpassed 3,000%, thus reducing the fiscal deficit to 0.66% of GDP. The value of its debt on secondary markets was 12% of its nominal denomination. Immediately, the government sent a bill for state reform, which was passed by Congress, defining the state-owned companies to be privatized and the conditions for privatization (Law 23,696).²⁸ In 1990, when the government privatized telecommunications the economy was still in crisis: annual inflation was above 2000%, growth had no resumed and debt values in secondary markets remained low. Moreover, Menem was desperately trying to build political resources before the 1991 legislative elections because he had been elected in 1989 on a populist platform and had to persuade his own party of the electoral benefits of his policy turnaround.²⁹ Privatization of telecommunications served this purpose well. It served to consolidate a support coalition and to reduce outstanding financial obligations by swapping debt for privatized assets in order to increase Argentina's international

²⁵ In 1982, the Chilean GDP dropped by more than 14%, the unemployment rate was 19.6%, the fiscal deficit was 3.5% of GDP, and annual inflation grew from 9.5% to 20.7% (Bosworth, Dornbush and Laban 1994: 32-33).

²⁶ Economic growth resumed in 1984 (6.3%) although the fiscal deficit was still high (4.3% of GDP) as was inflation (23%). However, even those indicators were improving by 1985 (Bosworth, Dornbush and Laban 1994: 32-33). Indeed, the state-owned companies produced a superavit of 0.57% of GDP by mid 1980s (Saez 1996:92).

²⁷ The finance minister mentioned four reasons for privatization in 1985. These were the importance of private property as a foundation for a market economy, the gain in efficiency derived from private control, the stabilization effect of a deepening in the stock market, and the spread of ownership (cited in Bitrán and Sáenz 1994: 342).

²⁸ Law 23,696 of 1989 singled out the list of state-owned companies to privatize or give in concession. It singled out telecommunications for privatization. The law also established transfer of companies to the provinces, subsidies for cooperatives and for programs of employee-owned stock, users-owned stock (never implemented), and for producers of products or services in the industry of the state-owned company.

²⁹ As another attempt to escape the crisis, the government introduced a bill that became law in March 1991 and pegged the peso to the dollar forbidding monetary emission in excess of reserves. This law was the cornerstone of the Convertibility Plan that served to control inflation and to recover Menem's popularity. In contrast, Carlos Andrés Pérez, in Venezuela, was abandoned by his party after his reforms were followed by a decline in its electoral performance. On the importance of party support for the success of market reforms, see Corrales (forthcoming).

credibility. Additionally, it was a sector where the crisis of delivery for business and residential business increased the popularity of this privatization (Molano 1987).

In Mexico, the privatization process started under the pressure of the debt crisis. However, it did not include large companies, nor public utilities until the administration of Carlos Salinas.³⁰ Salinas' privatizations were not only large but also successful for building a political coalition and for raising revenue to improve the electoral prospects of his party. He privatized the national telecommunication company in 1990. As in Argentina, the crisis of delivery and the need for investment made telecommunications an ideal case for privatization.³¹ In 1989, the high fiscal deficit (5.6% of GDP) and internal public debt (19.6% of GDP) further increased the attractiveness of a policy that would bring revenue to the Treasury.³² Furthermore, Salinas was elected in 1988 amidst fraud accusations and with a strong showing of the explicitly anti-neoliberal candidate Cuahutemoc Cárdenas, who had left the PRI. Hence, Salinas used privatization to concentrate political resources for improving his party's electoral performance in the 1991 midterm elections.³³ Salinas tried to maximize revenue that could be used to recover lost constituencies and to build a political consensus for privatization in response to his need for financial and political resources.³⁴

b) Regulating Privatized Markets

Privatization by conviction and privatization by necessity are associated with different ideological orientations regarding the role of the state in fostering economic development. Thus, they should be accompanied by distinct attitudes regarding regulations. The Chilean right-wing policy-makers distrusted state regulation and preferred unregulated markets.³⁵ In contrast, in Argentina and Mexico, we expect more regulations of privatized industries to “help” the market obtain the political goals that provoked the policy change of populist parties.

³⁰ The decision to start privatization followed the 1982 debt crisis. Between 1980 and 1982, the transfers from the federal budget to the state-owned enterprises were 3.6% of GDP. The pressure from the fiscal deficit along with the decline in oil prices in 1981 and the end to foreign financing in 1982 brought about the decision to start privatizing. However, the government only sold small companies with no economic priority during the administration of Miguel De La Madrid (1982-88) (Rogozinski 1997:101-102, 110).

³¹ The dramatic decline of Telmex started after the 1985 earthquake, which left Mexico City without communication. Most business moved out of downtown into the suburbs where there was not network at a time when there were no fiscal resources to cover the investment needed.

³² The returns of Telmex's sale in 1990 were 1.19% of GDP and were used to pay internal public debt, thus liberating resources for social spending (Rogozinski 1997: 150, Mariscal 2001: 74).

³³ Although Cárdenas was the candidate of the of the FDN (National Democratic Front), his positions still commanded PRI support. Salinas, thus, had to show the electoral popularity of his pro-market policies to his own party. Kessler (1998) argues that Salinas also used the financial resources of banking privatization for social policies that would give him electoral returns. The instrument was the National Solidarity Program (Pronasol), which was targeted to competitive districts.

³⁴ Carlos Cassassus, former Financial Vice-President of Telmex, undersecretary of Communications and head of the regulatory agency, personal interview, 12/8/00. The maximization of revenue also explains the sale of Telmex as a vertically integrated national monopoly according to all the high officials involved in the process including those supporting regional division (personal interviews).

³⁵ Their main economic program labelled as "the brick" was strongly anti-statists and advocated free-markets. See "El ladrillo: Bases de la política económica del gobierno militar chileno" (Centro de Estudios Públicos 1992).

Following its neoliberal ideological tenets, the Chilean scheme designed for the privatization of electricity and telecommunications did not establish any legal barrier to entry in these markets.³⁶ Nor did it regulate the functioning of the markets, lacking restrictions for vertical and horizontal integration. Moreover, in consonance with its neoliberal creed, the privatization did not impose investment or service targets to the newcomers.³⁷ In telecommunications, it refused to create a regulatory agency for the industry, leaving the regulatory functions for the policy-maker (Under-Secretary of Telecommunications). In electricity, although it inherited a control agency (Electricity and Fuels superintendence), it did not grant it with regulatory powers, which were scarcely given to a National Electricity Commission formed by a group of Cabinet members.³⁸ Neither did the government maintain any supervision of the independent system operator, in charge of electricity dispatch and controlled by large generators.³⁹

In contrast with Chile, Mexico created legal barriers to entry in the concession title of Telmex and retained the company as a vertically integrated monopoly.⁴⁰ The government was trying to create a “national champion” by restricting foreign control, and by granting monopoly rights and imposing investment targets to the winner. Mexican policy-makers still believed in using the state for developing a key sector of the economy.⁴¹ According to the head of the privatization unit, the telecommunications' privatization was used to maximize revenue, to open the international financial markets for the Mexican companies, to include workers in the process, and to retain the company as Mexican (Rogozinski 1997:126). In 1995, the government introduced a bill passed as the Federal Telecommunications Law. This law kept the restrictions to foreign control.⁴² It also created

³⁶ It established, though, different concessions for each service and privatized the two main companies with concessions for either long-distance or local communications in a 1987 reform.

³⁷ The 1987 reform in telecommunications let the privatized companies define their own areas of concession with obligation to serve demand of service within three years with no enforcement.

³⁸ The reticence to create regulators was kept in the right-wing legislators and the companies and hindered the efforts of following administrations to create regulatory agencies in these industries. The regulation further limited the autonomy of the CNE by imposing a weighed average between its measures and those of the providers. The SUBTEL was created in 1977 and the CNE in 1978 as part of the restructuring of the industries that preceded privatization.

³⁹ They also established the recourse to the Courts, which were not only independent from the Executive but were to survive it after the transition. However, the Chilean judicial system lacked economic or trade justice specialization to deal with regulatory issues.

⁴⁰ In addition to the nationwide local concession, it was given a nationwide mobile concession and a long-distance monopoly until 1997, and the microwave company Telex of Mexico.

⁴¹ Mariscal (2001) argues that in addition to the fiscal arguments supporters of a national monopoly and restriction to foreign control believed in the idea of a "national champion". My own interviews support this theory considering the view of supporters and opponents to the idea. The use of concession rather than sale of assets also left large discretion for the government. This discretion was used to deny concessions to other potential providers of local communication until the opening of the long-distance markets even in the absence of legal restrictions for investment-based competition at in local communications.

⁴² The 1995 Federal Telecommunication Law restricted foreign ownership to 49% and applied to all operators except IUSACELL, which had been previously sold to a Canadian investor. According to Cassassus (personal interview), the limitations to foreign control were imposed in Congress by PRI legislators, particularly those of the labor sector. However, Carlos Salinas was in favor of the original inclusion of the Mexican control clause in the concession of Telmex because he was in favor of strong Mexican business groups. The effect of this restriction was to increase the value of Mexican partnerships for foreign investors wanting to enter the

a regulatory agency for the industry (Cofetel) although the Secretary of Transportation and Communications restricted its autonomy.⁴³

In Argentina, the government created two vertically integrated regional monopolies for local and long-distance telecommunications and included coverage targets for them with the dual goal of promoting development and satisfying a large unmet demand.⁴⁴ It also created during the bidding process an autonomous regulatory agency for the industry, which was often put into receivership due to regulatory conflicts with the Executive in the immediate post-privatization period. The government also kept barriers to entry even in the transition toward deregulation by allowing only four operators for fear of market fragmentation.⁴⁵

In electricity, however, the regulatory power of the government was used to foster competition rather than restricting it. Different from Chile, regulations restricted vertical and horizontal concentration, provided for a mechanism of double overseeing in rates, and set quality standards to obtain low rates and efficient service delivery.⁴⁶ The privatization law of 1992 also created a regulator agency for the industry with powers to oversee market concentration. Additionally, the Secretary of Energy kept veto power in the independent system operator, in charge of electricity dispatch, where all the actors in the system (i.e. generation, transmission, distribution and large users) were included.

In Mexico and in Argentina, microeconomic regulations of privatized industries entered in conflict with macroeconomic policies. In both cases, populist governments chose to impose

market, thus subsidizing domestic business. Taking advantage of the 1995 law, the main Mexican private bank, Banamex associated with MCI based on its network and MCI's capital to form Avantel, one of the two main competitors to Telmex in long-distance since 1997. Simultaneously, the second bank of Mexico, Bancomer, associated with ATT and formed Alestra, which is the other main competitor of Telmex.

⁴³ Personal interviews with former Secretary of Communication and Transportation, Carlos Ruiz Sacristán (1/18/01), Undersecretary Carlos Cassassus (12/8/01), and their main economic advisor Rafael Del Villar (12/6/01). The latter opposed the restrictions to foreign capital and to Cofetel autonomy, such as the appointment of its members by the Secretary for non-fixed terms.

⁴⁴ As in Mexico, they were granted licenses for mobile service. To avoid competition in this and the long-distance service between the two regional monopolies, they received the licenses for their regions and half of the shares in the national long-distance company (Telintar) and in the mobile company of the metropolitan area of Buenos Aires (Miniphone), which was divided in two by the regional concessions.

⁴⁵ Roberto Catalán, then head of the regulatory agency, defended the decision of allowing only the four existent operators to the fact that they have already made investments in fixed and mobile network and thus would be stronger to compete avoiding a price war and the bankruptcy of some telecommunication companies as it happened in Chile (personal interview 5/11/99). The transition period was reduced to one year because the government extended the seven-year regional monopolies for two years and because Argentina had joined the WTO it was obliged to open this market by November 2000.

⁴⁶ The delivery crisis was acute by 1988 when the then publicly-owned distribution company had to ration electricity across the board. The Argentine Industrial Union (UIA) was, therefore, a big supporter of privatization and large industrial users were allowed to established long-term contracts and included in the regulation of the independent system operator, which sets wholesale electricity prices in the spot market. The industrial tradition of Peronism at a time of economic opening when the government was demanding increasing international competitiveness from industrialists is related to this outcome. In contrast, in Chile, the industrial sector was too weak and the main large users were in the mining sector, where the largest company was the state-owned Codelco that had its own generation in the Tocopilla central.

the macroeconomic goals showing that privatization was adopted by necessity as one more instrument for recovering political authority and fulfilling developmental goals.⁴⁷

c) Beneficiaries: Selling Conditions and Coalition Building

Each government defined the pricing and selling conditions according to the different constituencies targeted to consolidate a support coalition. In all cases, the political leverage of certain sectors within the government coalition served to grant them favorable conditions. This was important because privatization of public utilities include some of the largest assets to distribute, which also had a strong impact on everyday life.

In Chile, Pinochet tried to reinforce and broaden his political coalition by rewarding his core supporters, such as public officials and the military. He also tried to expand ownership to create a new class of property owners that would avoid a reversal to the failed socialist experiment of the early seventies. In the case of electricity, the spread of ownership or 'popular capitalism' scheme benefited employees, civil servants, the military, taxpayers without fiscal debts, and especially, managers of the privatized firms. The latter received shares with voting rights paid with loans that used the dividends of the same shares as collateral. Mutual funds were main buyers in the Santiago stock exchange. This scheme benefited a domestic business group constituted by former managers of the electricity companies who conformed, along with mutual funds, the corporations Enersis, Chilquinta and Gener.⁴⁸ Additionally, it dispersed ownership among sectors that were likely to support the right-wing project of Pinochet in the incoming plebiscite of 1988, such as middle and upper classes because the poor did not qualify for receiving these subsidies.⁴⁹ This privatization scheme did not maximize state revenue while subsidizing the dispersion of ownership.⁵⁰

In telecommunications, the same mechanisms were used to distribute shares among the military, civil servants and employees. Mutual funds purchased 30% of the long-distance

⁴⁷ The effect of macroeconomic variables on fiscal revenue, growth and inflation, and thus on elections makes governments prioritize them over microeconomic efficiency. For instance, the Argentine Executive took over the telecommunication regulatory in relation to price rebalancing to keep its Convertibility Program against inflation from judicial challenge. The Mexican government imposed higher interconnection rates to incoming competitors because it refused to let Telmex rebalance its prices during the 1995 financial crisis.

⁴⁸ The three corporation originated in the division of the distribution company Chilectra into three before privatization whereas Enersis also acquired control over Endesa (60% generation and 100% transmission in the interconnected central system or SIC with 80% of power in the country). Mutual funds had the majority of shares but they lack voting rights whereas the small percentage of shares with voting rights was concentrated by former government officials and managers. The head of the Enersis group, José Yuraszeck had been in the government planning agency, and then appointed as CEO of Chilectra before its privatization. The head of Gener, Bruno Phillipi, had led the National Energy Commission in charge of electricity privatization (Moguillansky 1999:190).

⁴⁹ The former head of the Privatizing Unit, Jacques Rogozinski (1997:122) criticizes the system arguing that the poor did not received ownership under "popular capitalism" and explained that for that reason was not used in Mexico.

⁵⁰ A former Minister of Pinochet calculated the subsidy implicit in the privatization of electricity distribution in 32% for Chilmetro (Enersis), 25% for Chilquinta and 22% for Gener (Luders and Hachette 1992). Devlin and Comminetti (1994) calculate for the sale of Endesa subsidies ranging from 7 to 20% for public employees, military, small investors, and company employees.

company in 1986 and 7.6% of the local company in 1987. Foreign investors also acquired 22% of shares in the long distance company ENTEL and 49.2% (along with management) in the local company CTC. Foreign investors brought capital, which was not available domestically. In both telecommunications and electricity, privatization created strong companies relative to the whole economy.⁵¹

In Argentina, Menem tried to use privatization to gain financial credibility--later used to fund his electoral coalition--by bringing in foreign direct investment while keeping links with domestic business and labor unions.⁵² Two regional telecommunication monopolies emerged from the former nationwide public monopoly. In each, 60% of the shares were sold to foreign investors in association with former state suppliers, and banks providing the debt. Employees received 10% of shares at long term subsidized prices, syndicated until their payment with union administration, cooperatives in the provinces received 5% of shares and the rest went public in the following years.

In electricity, foreign companies and former state suppliers bought most of the generation, distribution and transmission. In addition to the 10% share of workers, which was also administered by the union, the labor union acquired four small generators and two transmission regional companies whereas provincial cooperatives also entered the generation sector. In both industries, the largest domestic groups--grown under the shelter of state subsidies--bought privatized assets (e.g Techint, Perez-Companc, Clarin, Astra) and used them to increase their economic power.⁵³ In both industries, provincial cooperatives received subsidies adding another original member of the Peronist coalition to the beneficiaries of public utility privatization.⁵⁴ Finally, the delivery crisis and deterioration of services in both industries made these policies popular (Palermo and Novaro 1997).

In Mexico, Salinas tried to consolidate a coalition of domestic business sectors and "modern" labor unions while increasing his international credibility and fiscal resources to expand his popularity. The privatization limited foreign capital control of telecommunications and endowed the controller of 20.4% of AA shares with management

⁵¹ In 1996, the largest twenty public companies of Chile included Endesa (2nd), CTC (5th), Enersis (6th), Chilgener (7th), and Entel (18th) (Fazio 1997: 31).

⁵² The value of sovereign bonds in secondary markets had grown from 12% in 1989 to 70% its nominal value as early as 1994 (SALA vol 29, 31, part II) whereas the public foreign debt increased from 52.7 million dollars in 1991 to 67 million dollars in 1995, when Menem ended his first term (Basualdo 2000:220). These funds in addition to the revenue from privatization served to pay for the increase in provincial expenditures and personnel, which sustained Menem's congressional coalition (Gibson and Calvo 2001).

⁵³ The Argentine companies diversified to various industries in addition to public utilities. In the studied privatizations, Astra participated in electricity, Techint in telecommunications and electricity, Pérez Companc in telecommunications and electricity, and Clarin in telecommunications. The former three had been traditional state suppliers whereas the last one originated in a newspaper, which received subsidized paper from the state. Schamis (1999) argument seems to hold stronger for Argentina, where the "winners" of privatization had been the previous state suppliers, than for Chile and Mexico, where new domestic groups emerged from the public utility privatization. However, the nine domestic conglomerates that participated in privatization accounted for 4.3% of the sales and 14.6% of benefits of the largest 200 companies in 1995. In contrast, the 30 conglomerates emerging from privatization (mostly transnational) represented 17.7% of sales and 34.3% of benefits in 1995 (Azpiazu 1997: 53).

⁵⁴ Gibson (1997) defines the Peronist movement as conformed by two coalitions, a metropolitan one including labor unions and industrialists, and a peripheral one based on provincial bosses.

voting rights imposing that 51% of those should be Mexican-owned. In the case of Telmex, a new domestic business group (CARSO) in association with Southwestern Bell and France Telecom won the bid and retained management rights. This purchase strengthened a new business group, which would become the largest one in Mexico since the Salinas' administration.⁵⁵ Additionally, the subsidized employee-owned shares (4.4%) were syndicated and administered by the union until their total payment and the rest of the shares went public in the following years.⁵⁶ Domestic business and labor unions allied with Salinas constituted a privatization coalition in telecommunications of similar characteristics to the traditional nationalization coalition.

The distribution of property resulting from privatization of public utilities benefited government allies. In Chile, privatization served for the emergence of new economic conglomerates, such as Enersis, Gener, and Chilquinta, conformed by former managers, government officials and military. The dispersion of ownership, in particular, facilitated management control by these groups. The goal was to maximize the political effect of privatization, even at the expenses of fiscal revenue.⁵⁷ In Mexico, the coalition included domestic industrialists and the labor union in the privatization of telecommunications. The goals were to create a strong "Mexican" company, to maximize fiscal revenue, and to build domestic political support. In Argentina, the privatizing coalition included the old state suppliers, foreign investors (creditors and operators), and labor unions as well as provincial interests. The goals were to win financial credibility and domestic political support.

The following table summarizes the impact of ideological orientations and political alliances in the case studies of public utility privatization. Chile had a right-wing government privatizing by conviction, even after the failure of its first privatization experience of the 1970s. Argentina and Mexico had populist governments privatizing by necessity to recover state authority while escaping from economic crises and political challenges. The outcomes in terms of origin, regulations, and beneficiaries match most of the predictions in table 1.

⁵⁵ The losing consortium was integrated by Accival, Telefónica and GTE. Salinas also privatized the banks nationalized in the 1982 and Accival acquired the largest private bank in Mexico, Banamex. The origins of Accival and Carso were similar. They were originally brokers whose fortunes grew by selling dollar-denominated government bonds during the 1980s rather than part of the old business conglomerates (Mariscal 2000). Accival's Roberto Hernández and Carso's Carlos Slim also opposed the division of Telmex before the sale. Slim ranked 54th among the wealthiest in Mexico during the 1980s and by 1999 became the wealthiest person in Mexico and Latin America (Mariscal 2000: 75).

⁵⁶ The union leader, Francisco Hernandez Juarez, was a supporter of privatization and a close allied to Salinas.

⁵⁷ In the concession of waves for mobile telecommunications, there was no payment involved, just service obligations.

Table 2- Public Utility Privatization in Chile, Argentina, and Mexico (outcomes)

	Chile	Argentina	Mexico
Government	Right-wing	Populist	Populist
Industries	Telecom + Electricity	Telecom + Electricity	Telecom
Origin	By conviction	By necessity	By necessity
Regulation	No legal monopolies No limits to concentration No coverage targets in telecom No quality standards in electricity No regulatory agency in the industries	Legal monopolies in telecom Limits to concentration in electricity Coverage targets in telecom Quality standards in electricity Regulatory agencies in electricity and telecom	Legal monopolies in telecom Investment targets in telecom Regulatory agency in telecom
Domestic Beneficiaries	Middle classes/managers Military	Domestic K Labor union Cooperatives/provinces State (resources)	Domestic K Labor union State (resources)

The influence of politics should be higher during privatization than in the already privatized markets. However, the political incentives, which influenced the different patterns in the implementation of public utility privatization, can interact with electoral competition to facilitate post-privatization regulatory reform. Electoral turnover in combination with ideological orientation and demands derived from the concentration of privatized markets, provide incentives for post-privatization regulatory reform, which changed the gains of the beneficiaries from privatization.

In the post-privatization period, electoral competition can bring the former opponents to privatizing governments to power. Committed left-wing or populist competing with privatizing government have political incentives to promote regulatory reforms reducing the gains from the incumbents emerging from privatization, who were allies of their contenders. Other regulatory reforms, including those favoring incumbents, may take place under the privatizing government, but electoral turnover is usually required for reforms that reduce the gains of privatization winners. If left wing or populist parties seeking the support of the sectors that benefited the less from the original privatization arrived to power, they have incentives for this type of regulatory reform. Because the three countries studied experienced an electoral turnover after privatization, the next section focuses on the implications of this event on the political incentives of the newcomers for regulatory reform.⁵⁸

⁵⁸ The absence of an institutional tradition of autonomous regulatory bodies should facilitate reform in transitional economies.

IV-The Aftermath of Privatization

This section does not attempt to explain all regulatory policies in the already privatized industries.⁵⁹ Instead, it analyzes the reforms that curtail the gains of those that benefited the most from privatization. If political alliances and ideological orientation influenced privatization and its beneficiaries, similar political incentives should work for opposition political parties once they get to power regarding post-privatization regulatory changes. The argument is that when privatizing governments lose power the newcomers have political incentives created by their own ideological orientation and their search for political coalitions. These incentives, in combination with the demands produced by property concentration in privatized markets, explain regulatory policies targeted at reducing the gains of incumbent companies.

Market concentration creates demands for regulatory change. High market concentration usually affects prices and coverage generating demands from consumers and prospective investors on the regulator to modify the gains derived from the original privatization. Ideological orientations influence the political incentives of policy makers to respond to these demands by defining their attitudes toward regulation and their political base of support. Hence, the ideological orientation of the incoming government creates the incentives to push for these regulatory demands in the public agenda although the power of concentrated privatized companies, and other institutional factors, can curtail their success in implementing these efforts.

In all three countries, electoral competition brought a party different from the privatizing one to power after privatization.⁶⁰ In Chile and Argentina, the successor governments were center-left coalitions that had criticized the privatization processes. They campaigned on platforms that promised more regulations of large monopolies and the defense of consumer rights. Seeking consumers as their constituencies, they even created agencies to defend consumer rights once in office. In Mexico, the center-right successor party had supported privatization, and did not campaign on increasing regulations or defending consumer rights.⁶¹ Hence, the ideological incentives for regulatory reform against the incumbents were higher for incoming policy-makers in Chile and Argentina than in Mexico.

In Chile, the center-left political parties of the *Concertación* coalition had strongly criticized the public utility privatization processes. In particular, they denounced privatization undertaken after the 1988 plebiscite that established a two-year transition to democratic elections instead of the continuation of Pinochet's rule, including telecommunications and electricity. The 1989 platform of the *Concertación* states "... In the

⁵⁹ The literature on regulatory reform highlights the influence of diverse variables such as bureaucratic relationships (Laffont and Tirole 1993), organized interest groups (Noll 1989, Weingast and Moran 1983), political entrepreneurs (Derthick and Quirk 1985), technological innovation (Horwitz 1989), regulatory capture (Stigler 1971), institutional context (Levy and Spiller 1995), etc.

⁶⁰ In the case of Chile, I am considering the right-wing parties, which campaigned as Pinochet's heirs, against the coalition of Christian-Democrats, Radicals, and Socialists (*Concertación*) that succeeded him.

⁶¹ The electoral turnover happened before in Chile than in Argentina and Mexico, considering the start of public utility privatization, but the political incentives of incoming governments were more similar in Chile and Argentina.

future, nationalization or privatization will only take place when the society reaches a broad consensus as expressed by Congress." (*Concertación* 1989: 13). It also proposes for public services that "...in the cases of monopolies that had to have their prices regulated by the state, we will apply stable and objective price policies to promote the efficiency and growth of these companies while defending the interests of the community." The *Concertación* also committed itself to complementing markets with "efficient public regulatory and corrective actions." (*Programa de Gobierno de la Concertación* 1989: 14)⁶² The *Concertación* won the 1989 elections and its candidate, Patricio Alwyn was inaugurated in 1990 as President of Chile.

During President Alwyn's administration (1990-94), there was a regulatory reform in telecommunications. Because the *Concertación* did not control Congress, it had strong limitations to pass laws.⁶³ Thus, the government had to drop from the bill its proposal to create a regulatory agency for the industry. The new law was passed in March 1994 and established the rules for competition in long-distance (with a compulsory multi-carrier system and no default carrier).⁶⁴ It also established a Fund for the Development of Telecommunications to achieve universal coverage using budgetary resources to contract private companies bidding for the lowest subsidy (Law 19,302). The multi-carrier system did not discriminate in favor of the two major incumbents (CTC and Entel). Nor did it include investment requirements, which would have discriminated in favor of the incumbents emerging from privatization.⁶⁵ Thus, it favored new entrants explaining the dramatic increase in the number of operators and the decline in long-distance prices (and Entel's revenue) achieved within a year of the reform.⁶⁶

In electricity, the government was afraid of sending a bill that would not pass Congress due to the lobbying power of the companies privatized by Pinochet.⁶⁷ During the second government of the *Concertación* (1994-00), policy makers tried to re-regulate electricity with new administrative rules for the sector rather than failing to pass a law in Congress.

⁶² The program of Hernán Büchi, the right-wing candidate and Pinochet's Finance Minister at the time of public utility privatization, had not mention to regulations and its only mention to consumer rights was: "consumers are often ignored in the mixed economies promoted by our opponents. Instead, in the market economy, the consumer is the sovereign." (*Programa de Gobierno de Hernán Büchi*, 1989: 16).

⁶³ The constitution inherited from the military regime imposed non-elective Senators effectively guaranteeing the control of this chamber by right-wing parties and their military allies until 1999.

⁶⁴ In telecommunications, Telefónica bought CTC in 1990. Telefónica was then a state-owned company where the Socialist government of Spain had a strong voice and the president of CTC was a former Socialist politician who had been in Allende's cabinet. Their relationship with the government was close and they supported the legal process in contrast to ENTEL, which was perceived as a right-wing company due to the links to former Pinochet's officials. During the legislative debate right-wing parties sided with Entel in favor of regulated segmentation against CTC and Socialist and Radical legislators in favor of regulated vertical integration (Legislative Debate 1994).

⁶⁵ Only Entel, CTC and Chilesat, which emerged from the privatization, had nationwide networks.

⁶⁶ In 1995, nineteen long-distance operators started to compete and Entel's share dropped to approximately 40% of the domestic and international long-distance markets (Ahumada 2000:16-17). The benefits of Entel dropped from almost 50% of return to its capital in 1993 to 17% in 1995 (Moguillansky 2000: 244). By 1996, Chilean long-distance prices were among the cheapest in the world (p.230-31).

⁶⁷ In contrast to CTC, the main companies of the sector (Enersis/Endesa, Chilgener and Chilquinta) were perceived as linked to Pinochet. Because *Concertación* politicians had denounced their privatization as a scam, they distrusted the government creating a strong front against legislative change (Rivera 1999: 182).

The main innovation was on the independent system operator, which controls the dispatch of electricity, where other operators in addition to Endesa and Gener and the still state-owned Colbún were admitted. In addition to this reform, the government forbade incumbent generators to participate in new privatization processes (fundamentally Colbún with 12% of the power in the SIC). It also promoted gas interconnection with Argentina to facilitate competition from thermal generation in a mostly hydro generated system (Rivera 1999:182).⁶⁸ The goal in both cases was to limit the market concentration created by privatization where Endesa concentrated 60% of generation and Gener 18.5%.⁶⁹ In 1999, the government responded a delivery crisis provoked by shortages in generation by passing a law increasing sanctions to the companies. Hence, in both industries, the *Concertación* used public policies to increase competition, reduce prices, and expand coverage to bring consumers into the government coalition.⁷⁰

The incentives for electoral competition were similar in Argentina although the pragmatic Peronist party had been in charge of privatization making the shift less dramatic. After the second term of Menem as President, his party lost the 1999 election to a center-left coalition, the *Alianza*.⁷¹ The parties in the *Alianza* had criticized the privatization processes. In the discussion of the electricity privatization bill, the representatives of UCR and the Socialist parties opposed to the Executive proposal.⁷² Its 1999 electoral platform expressed that "an adequate regulation of public utilities and a policy for defending competition are necessary tools to improve equity...[because]...In many cases, the privatization provoked increases in prices due to the monopolistic structure of markets." They committed themselves to defending consumers, promoting competition, and creating pro-competitive regulations that considered the public interest where competition was absent. They also promised autonomous and transparent regulatory agencies with consumers' participation (*Alianza UCR-Frepaso* 1998: 11-12).⁷³

Concentration was high in telecommunications, where Telefónica and Telecom had almost equally divided the local and long distance markets due to the privatization design. The

⁶⁸ Endesa, and most of the SIC, were based on hydro generation and Endesa had also acquired the water rights during privatization.

⁶⁹ In addition, Endesa had 100% of transmission in the SIC and 45% of distribution. Gener had 15% of distribution and Chilquinta 8% (Moguillansky 2000).

⁷⁰ It also passed a law to defend consumer rights although curtailed by congressional opposition from right-wing legislators.

⁷¹ The *Alianza* joined the Radical Civic Union (UCR), which had preceded Menem in government, and the FREPASO, itself a coalition of left-wing political parties, including Socialist and former Peronist who quitted the party after Menem policy shift toward market policies and privatization.

⁷² In 1989, the UCR had given quorum for law 23,693, which allowed the privatization of telecommunications, as a result of an agreement with outgoing President Alfonsín to accelerate the inauguration of Menem before that of the new Congress due to hyperinflation and social turmoil. In the 1992 discussion of electricity privatization, the UCR representatives presented a minority proposal. Their proposal established that generation was a public service rather than a competitive activity, increased the regulatory powers of provinces in distribution and wholesale, demanded state administration of the system operator, allowed public companies to bid for concessions, proposed state investment in generation, and limited the privatization of the regional companies (Debate on Law 24,065, National Congress, 1992).

⁷³ Different from Chile, the Peronist party had joined privatization out of pragmatism and their 1999 electoral platform stated that regulations would be used to promote universal coverage in water, electricity, and telecommunications (Electoral Platform 1999:2.9).

Menem administration had extended their regional monopolies for two years and established a transition period of one year during which the two companies could compete with each other and with the other two mobile companies based on investment requirements, which favored incumbents.⁷⁴ In 2000, the government had to define the rules for opening both the long distance and the local markets. The new *Alianza* government chose a system that allowed for service-based competition. Interconnection prices dropped sharply and investment requirements were limited to two dollars per customer in the self-defined areas of service despite strong opposition from the incumbent companies and legislators, who worried about the expansion of coverage (Congressional Public Hearings, June 2000). The regulation also created a fund to provide for universal coverage paid by the operators, and established the multi-carrier system. The goal of the government was to cut prices and bring new investment into the country in order to build a coalition including prospective investment and consumers.⁷⁵ In contrast to telecommunication, the electricity market was competitive and there were no demands from its actors to change regulations.⁷⁶

In Mexico, the PAN (National Action Party) had been a supporter of privatization and the 2000 electoral platform of his presidential candidate, Vicente Fox, had no mention of consumer rights, regulating monopolies, or public utility reform except for "private investment in the electricity sector" (Propuesta de Campaña de Fox 2000). In contrast, the PRI platform promised to "promote private and social investment in the electricity sector under strict regulation from the state and provided that it contributes to its modernization, efficiency and the extension of its coverage." It also promised to keep the main state-owned company in electricity and the state monopoly of electricity generation (Plataforma del PRI 2000: 6.2.6).

Before Fox's inauguration, the telecommunications' market was very concentrated despite the opening to competition in 1997.⁷⁷ The main companies in the sector had been fighting in court for the price of interconnection. One competitor even denounced Telmex's

⁷⁴ Three other companies providing data transmission were left out of the scheme and one of them (Impsat) attempted a judicial recourse.

⁷⁵ A group of prospective investment, notably American firms, signed a petition to the government in support of the new regulations during the debate. Incumbent companies accused the Secretary of Communications of favoring incoming investors because he had been a lawyer for firm offering data transmission services, which was excluded from competition by the previous regulations restricting competition to four operators. The government had also created a new office for the defense of competition and consumers, which had an active role in the drafting of the regulation (personal interviews with high government officials and company managers).

⁷⁶ In contrast to Chile, in Argentina, the privatization of 22 generators led to only two corporations having more than 10% of generation: Duke (15%) followed by the Chilean Enersis (12%). Distribution was divided among 21 companies and transmission in one central and 5 regional ones (Bastos and Abdala 1995). Despite the consumer discontent that followed a shortage in the city of Buenos Aires, all companies in the sector supported the system. However, in 1997 Endesa Spain acquired Enersis in Chile and its assets in Argentina. As a result of this operation and its previous acquisitions in Argentina, it had property in the two regional monopolies of distribution in which the City of Buenos Aires was divided (Edenor and Edesur). The regulatory agency denounced horizontal concentration. In 2000, the new Secretary for the Defense of Competition and the Consumer created by the *Alianza* ruled that it had sell its property in one of the two to preempt horizontal concentration.

⁷⁷ By 1999, Telmex share of the long-distance market was 79%, Avantel 9%, Alestra 11%, and others 1% whereas Telmex had more than 90% of the local market (Mariscal 2001). Unfinished Business, mimeo.

dominant market position in the Federal Anti-Trust Commission, which ruled its dominance in five markets, and the USTR was pressing for this denounce in the WTO. Fox also faced strong demands for change in the regulatory agency due to its inability to enforce regulations. Despite these demands and the activity of PAN legislators as presidents of the Communication committees in both chambers, regulatory reform did not appear in the public agenda in the first nine months of Fox's administration. Instead, the Secretary of Communications and Transportation promoted an agreement between the companies on the interconnection prices that made them drop their law suits based on a financial compensation of mutual debts.⁷⁸ The following table summarizes the cases or regulatory reform discussed.

Table 3- Political Incentives, Market Demands and Regulatory Reform

	Concentration after Privatization	Ideology of new government	Reform against incumbents
Arg. Telecom	High	Center-Left	Yes
Arg. Electric	Low		No
Chile Telecom	Medium	Center-Left	Yes
Chile Electric	High		Minor
Mex. Telecom	High	Center-Right	No

In the studied cases, political incentives--based on electoral competition and ideological orientations and political coalition building--interacting with demands derived from market concentration influenced regulatory reforms. The institutional weakness of regulatory agencies and legislative overseeing in new democracies probably reinforced this effect.

V- Concluding Comments

This paper shows the influence of politics in seemingly technical or "de-ideologized" policy choices. This argument builds upon a large literature on the politics of privatization. However, this paper differs from previous work in that it does not restrict political influence to policy preferences for privatization. Nor does it limit it to the successful implementation of a technically defined policy based on executive authority, fiscal crisis, or concessions to fend off opposition. Instead, it defines this influence in different dimensions of the privatization of public utilities. In doing so, it explains the different choices of privatizing policy makers, whether they were right-wing governments as in Chile or populist parties as in Argentina and Mexico. This paper concludes by arguing that if political incentives explain policy choices undertaken at the time of privatization, they should have an influence in the policy alternatives available for parties competing with privatizers. Electoral competition provided incentives to provide policy options in response to demands generated by asymmetric markets. Electoral competitors to privatizing

⁷⁸ Fox's Secretary of Communications and Transport, Pedro Cerisola Weber, was a former Telmex manager whereas the secretary of Finance, Francisco Gil, was the former Avantel CEO. The agreement imposed costs on new entrants and smaller carriers (personal interviews with managers of telecommunication firms in Mexico).

governments sought to attract new investors and consumers into their coalitions by promoting regulatory reforms reducing the gains of incumbent companies in Chile and Argentina. In Mexico, though, regulatory reform has not appeared in the policy agenda yet due to the support of incumbents of companies for President Fox and his own ideological orientation.

Further research should cover other variables in the post-privatization regulatory process with particular emphasis in the dynamics of business strategic decisions and consumer organization and protests. Providers and consumers are key political constituencies derived from public utility privatization, whose demands, along with technological change, influence the limits of what policy makers can do to follow their political incentives and ideological orientations. Additionally, the effect of weaker institutional legacies in terms of autonomous regulators and legislative overseeing is important to assess the voice of different market actors in these new democracies.

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